an earlier filing with the Securities and Exchange Commission, made under the penalty of perjury, TCI stated that it expected to be able to satisfy its debt service and other obligations, regardless of rate regulation. See Tele-Communications, Inc., Prospectus, filed with the Securities and Exchange Commission, May 25, 1993 at 3.[13]

The FCC has created one safety net for cable investors and bankers through benchmarks. It should not create a second, more generous one through cost of service. The industry is pleading for protection of its speculative investments and loans, made in anticipation of continued unregulated monopoly prices. That was a bad bet. And consumers should not be held as the guarantors against the foolishness of cable investors and their bankers.

The industry has not submitted data which demonstrate any substantial banking industry distress caused by the introduction of regulation. Unless and until the banking regulators conclude an issue exists, the FCC should ignore the claims. The FCC and/or subscribers are not guarantors of cable investors.

C. The FCC Should Not Permit Operators to Receive a Return on Programming

Several operators claim that they should be allowed to recover programming investment costs plus a mark-up. See TCI

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[13] TCI's current filing to the FCC does not point to any change in facts since the date of its SEC filing. The discrepancy between the two filings is inexplicable and the FCC should rely on those representations made under oath over those filed without similar formality.

comments at 33. The Local Government Coalition disagrees. Programming should not be treated any differently from other operating expenses, for the reasons stated in the Local Government Coalition's comments at 7. There is no basis for allowing such a mark-up. Operators benefit from providing high-quality or popular programming. It enhances the value of their service and increases subscribership. There is no need to give operators a double recovery by including the programming first, as an expense, and then a second time as an investment.

Allowing a return on programming investments creates the very type of perverse incentive the industry itself warns against. TCI comments, Besen/Woodbury study at 31. That study notes that, if the rate of return is set too high, it encourages inefficient investment. The logical solution therefore is to disallow any mark-up on programming expense. Operators will add programming without consideration of whether it can be supported by the marketplace, because they are guaranteed a profit.

D. Only Costs that were Reasonable, Prudent, and Intended to Benefit Subscribers of Regulated Services Should Be Included in Regulated Rates

The cable industry suggests that the FCC should permit virtually every cost incurred to be included in regulated rates. The Local Government Coalition disputes many of the industry proposals. Only costs actually attributable to regulated services and beneficial to those subscribers should be included in regulated rates. *American Television Relay, Inc.*, 65 F.C.C.2d at 393. For example, some operators claim that excess channel capacity should be included in regulated rates. NCTA comments at 18. In many cases, however, much or all of that capacity will not be used for regulated services. The cable industry is developing high-channel systems which will be used to provide on-demand pay-per-view services. Discovery Debuts Remote for 500-Channel Service, Multichannel News, December 14, 1992 at 1, 54; Time Warner Plans Electronic 'Superhighway', The Wall Street Journal, January 27, 1993 at B1. Subscribers to regulated services should not be required to pay for costs of constructing a system that will not serve them. The burden should be on the operator to show that unused channel capacity or similar investments will enhance regulated services. Moreover, operators must show that such investments were prudent. See Time Warner comments at 28, recognizing that some questions of prudency may arise.

E. The FCC Should Not Permit Recovery of Tax Expenses Not Incurred

Most operators reject the FCC's proposal not to include income taxes for Subchapter S Corporations, individual owners and partnerships. But the FCC's suggested approach is correct. In general, the FCC should only recognize taxes to the extent that taxes were in fact paid. Where no tax was paid, no tax should be recognized. Where a tax was paid, it should only be allowed for the actual amount incurred. Many operators pay taxes at a rate substantially lower than the statutory rate.[14] They should not be permitted to utilize an artificial tax rate to increase regulated rates. To the extent that a particular businesses or certain types of business realize a tax benefit, those benefits should be passed on to subscribers through reduced rates.

III. THE FCC MUST INCLUDE A PRODUCTIVITY OFFSET

Operators claim that a productivity index may be difficult to establish, but that does not explain why one should not be developed. Time Warner comments at 41; Continental comments at 88-91. The Local Government Coalition believes that the FCC must establish an appropriate productivity index for the cable industry. It supports the positions taken by GTE Service Corporation and Bell Atlantic, et al. See e.g. GTE comments at 20-21 and Schankerman study; Joint Bell comments at 10-13.

IV. NONE OF THE "STREAMLINING" APPROACHES ADVOCATED BY THE CABLE INDUSTRY ARE VIABLE

The cable industry offers several suggestions for "streamlining" cost of service proceedings. In general, the industry argues that the benchmark system should be carried over in cost of service, with certain additional costs added to the benchmark rates. However, most of the suggestions amount to

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[14] See Profits to Become Benchmark at TCI, Cable World, March 22, 1993 at 29; MSOs Facing $2B Hit From New FASB Rule, Multichannel News, April 5, 1993 at 33 (noting that cable companies realize tremendous deferred tax liabilities through industry accounting practices).

devices to isolate individual cost factors which may be above the norm, while ignoring other factors that are below the norm. The effect is to add selected costs on top of the benchmark rate, thus increasing the overall rate. See Continental comments at 91-95; TCI comments at 64-67; Time Warner comments, NERA study. These types of proposed, selective cost add-ons to benchmarks defeat the very purpose of price cap regulation. They eliminate efficiency incentives, and insulate high cost producers. And they penalize consumers by denying them the benefit of below cost factors which would offset the cited high cost factors to yield an overall reasonable rate. Even some industry commenters recognize that streamlining approaches should not automatically allow high-cost operators to pass through all of their costs without justification. Time Warner comments, NERA study at 30.

Moreover, allowing operators to increase rates above benchmarks by making a partial showing of costs, without more, violates the mandate of the 1992 Cable Act. The Act requires that regulated rates be no higher than those that would exist in a competitive market. 47 U.S.C. § 543(b)(1). See also Report and Order, at ¶ 8. In a competitive market, high-cost providers cannot remain in business unless they are able to provide a superior service that justifies the higher rates they need to charge. Allowing operators to charge rates above those determined by the FCC to be competitive (i.e., benchmark rates), without demonstrating that those high costs are justified, contravenes the competitive rate requirement set forth in the 1992 Act.

Further, the types of streamlining approaches endorsed by the cable industry look only to costs, and ignore the possibility of offsetting revenues. Such one-sided analysis is flawed. For example, unusually high programming costs may be more than offset by the increased subscribership it stimulates. But the review should not be limited to offsetting revenue derived from that particular cost. Instead, <u>any</u> above-average revenues should be considered in determining whether, and how much, above-benchmark rates should be allowed based on above-average costs. <u>Duquesne Light Co. v. Barasch</u>, 488 U.S. at 314 (errors to the detriment of a party may be canceled out by countervailing errors or allowances in another part of the rate; critical issue is whether final rate order is just and reasonable).

Both the FCC and other regulatory agencies have long imposed a heavy burden of proof on regulated entities seeking to justify a rate above the price cap or established norm. <u>Policy and Rules Concerning Rates for Dominant Carriers</u>, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786, 6823 (released October 4, 1990) (fairness to ratepayers requires FCC to set high hurdles for above-cap increases); <u>MacDonald v. Federal Power Commission</u>, 505 F.2d 355, 364 (D.C. Cir. 1974), <u>cert. denied</u>, 421 U.S. 912 (1975). Such intensive review is not optional; it is mandated by the regulator's obligation to protect the public interest. <u>Scenic Hudson Preservation Conference v. Federal Power</u>

Commission, 354 F.2d 608, 620 (D.C. Cir. 1965), cert. denied, 384 U.S. 941 (1966); MacDonald, 505 F.2d at 364. In MacDonald, the court said:

> But when the Commission permits an individual producer to depart from an area rate structure which has been developed with reference to average area-wide costs to provide producers a necessary but not excessive profit incentive for gas exploration, its regulatory trust requires it to give complete consideration to that producer's individual costs in order to ensure that the producer's profit margin is not thereby raised to an unreasonable level.

Id. (emphasis added). Such consideration requires review of revenues as well as expenses. Id. While simply adding on additional cost items certainly serves operators' interests, it provides no protection to ratepayers, and therefore is not allowed.

The streamlining approaches advocated by the cable industry are problematic for other reasons. As the FCC and the industry concede, benchmark rates may be too high or too low in a particular instance. Report and Order, at ¶ 29; Continental comments at 93. Therefore, adding on amounts on top of the benchmark rate, without first determining whether the benchmark rate is adequate or even overly generous, is certain to lead to excessive rates. Moreover, allowing the proposed partial cost showings effectively eliminates the opportunity for regulators to set rates below benchmarks where the evidence shows it is warranted. Operators will never implement a full cost-of-service proceeding where a full review would reveal that costs overall demand a below-benchmark rate.[15] Selective and partial cost showings will likely skyrocket the number of cost of service petitions by the industry. In short, if the FCC seriously wishes to limit cost of service proceedings to those instances where they are truly appropriate, it should not allow the streamlined procedures urged by the industry.

V. THE FCC SHOULD NOT PERMIT OPERATORS TO CHOOSE DIFFERENT REGULATORY APPROACHES FOR DIFFERENT TIERS OF SERVICE

The Local Government Coalition believes that the FCC should require operators to choose a single regulatory method for all service tiers. Some operators claim that requiring a single regulatory approach will increase the number of cost of service proceedings, and hence will create unnecessary administrative burdens. The opposite is true. If the FCC sets appropriate guidelines, a single regulatory approach by cable systems can substantially reduce administrative burdens on regulators in general and on the FCC in particular.

The first step, as noted in Section I above, is to create a presumption that each system must use benchmarks. To overcome this presumption, the system must show that benchmark rates will not permit it to obtain a reasonable return on the system.

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[15] At a minimum, if the FCC permits the operator to elect a partial cost-based showing, it must give the regulator the option of requiring a complete review of all revenues and expenses. To ease the FCC's administrative burden, and to help it track information relevant to the locality for which the rate is being reviewed, the FCC should permit the franchising authority and/or the complainant to assist the FCC in cost of service proceedings.

Second, any system operator initiating a cost of service proceeding in any franchise area must notify the regulators of all other franchise areas served by the same system. And the operator should also notify any other franchise authority in which it has filed a cost of service proceeding. For example, if TCI initiates a cost of service showing in a suburb of a metropolitan system in Florida, TCI must join all the jurisdictions served by that system into the same claim and must notify that franchising authority of every other area in the country in which TCI has also instituted a cost of service proceeding. The metropolitan area regulators can then pool resources to review the rate filings and assure consistent treatment between franchise areas served by the same system, and can also get information on other TCI systems to assure against misallocation of costs.

Any time an operator intends to make a cost of service showing with respect to basic service, it must initiate that proceeding no later than the date on which it initiates a cost of service proceeding for non-basic tiers, and vice versa. Each proceeding must be filed on the same date on which it initiates a cost of service proceeding for any tier. The FCC and local regulators have a common interest in uniform treatment and efficiency of process. The operators should not have the option of forum shopping or inconsistent results between jurisdictions. An operator should not be allowed to seek an increase based on cost of service for a non-basic tier, and then wait until the FCC has conducted substantial review before filing a cost of service showing for basic service. Because there are no set deadlines within which the FCC must issue a rate decision, the FCC should generally wait for and rely on the local franchising authorities' findings regarding basic service. This would greatly reduce the number of cost of service showings and encourage all the affected local jurisdictions to cooperate. The FCC would be entitled to rely on findings made in the basic service rate proceeding. This reliance would largely eliminate any duplication of effort. Finally, the FCC must require operators to present in all cost of service proceedings, local and federal, evidence of all joint costs and joint revenue offsets. This is necessary to ensure that costs are consistently and appropriately apportioned within a company. Regulators in subsequent proceedings can then utilize this information, further reducing duplicative work.

Requiring operators to use the same regulatory approach for all tiers of service will reduce the initiative to forum shop and to file multiple proceedings hoping for success in one that can then be used to whipsaw other jurisdictions. Limiting operators to cost of service option only when they truly are unable to receive adequate revenues under the benchmark rate structure will avoid rule shopping to get results above reasonable rates. These additional procedural guidelines will encourage joint efforts among communities, economy of proceedings, and cooperative efforts between local franchising authorities and the FCC. Unlike the "streamlining" suggestions made by the cable industry, these proceedings will truly reduce burdens on operators and regulators, protect subscribers from excessive, uncompetitive rates, and still allow relief on a streamlined basis for operators for whom benchmarks yield an unfair result.

Respectfully submitted,

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